

Michigan Department of Natural Resources POLICY AND PROCEDURE

27.23-14 - Oil and Gas Leasing (Revised: 11/30/2021)

Supersedes:

27.23-14 – Oil and Gas Leasing (Revised: 11/20/2018)

27.23-15 – Oil and Gas Lease Classification (Revised: 07/11/2005)

27.23-18 – Oil and Gas Lease Maintenance (Revised: 07/11/2005)

Issue/Purpose:

To outline a process the Department of Natural Resources (DNR) shall follow for entering into contracts that provide access to State-owned mineral rights for the purpose of oil and gas exploration and development.

Definitions:

Amendment: A change in the original terms of an oil and gas lease.

Assignment: A transfer of working interest in an oil and gas lease.

<u>Bonus</u>: A one-time payment by the Lessee to the Lessor at the time of the auction or direct lease as part of the consideration for acquisition of an oil and gas lease or extension thereof.

<u>Drainage</u>: Drainage of oil, gas, and/or liquid hydrocarbons from beneath unleased State-owned lands from off-set wells located on adjacent lands.

Extension: The period after the expiration of the primary term of an oil and gas lease.

<u>Land Administrating Division (LAD)</u>: The division identified within an Order of the Director to manage all land use responsibilities and apply the Department's mission and management philosophy, policies and procedures to the land(s). The three primary Land Administrating Divisions include Forest Resources Division (FRD), Parks and Recreation Division (PRD), and Wildlife Division (WLD).

Land Ownership Tracking System (LOTS): DNR's electronic land management database.

<u>Lessee</u>: The person or entity that is responsible for all covenants, express or implied, in the lease regardless of any partial interest assignments.

Lessor: The Director of the DNR or the Director's designee, on behalf of the State of Michigan.

<u>Parcel Classification</u>: Parcels are classified for mineral leasing based on their natural resource features. Classification categories consider the effects of oil and gas exploration, and potential development could have on current and future land uses and other resource values and recognize the DNR's responsibility to manage the land surface (and the expertise DNR resource specialists possess to help mitigate impacts to privately owned surface rights). Mineral leases

are then classified based on the parcel classification within that lease. Classification categories are:

- Leasable Development (LD) Leasable mineral rights on which some level of surface use may be allowed in compliance with standard oil and gas lease terms and all state and local laws, rules, regulations, and requirements.
- Leasable Development with Restriction (LDR) Leasable mineral rights on which some level of surface use may be allowed in compliance with standard oil and gas lease terms and with additional specific restrictions due to environmental or other surface feature conditions.
- Leasable Nondevelopment (LND) Leasable mineral rights where no surface use or disturbance is authorized without separate approval.
- Nonleasable (NL) Lands that will not be leased for oil and gas exploration, development, or production.

<u>Parcel Review System (PRS)</u>: DNR's application used for coordinating and tracking mineral lease nominations and parcel classification reviews.

<u>Pooling Agreement (PA)</u>: An agreement to bring together separately owned mineral interests for the purpose of obtaining a cohesive drilling unit to drill one specific well under the applicable spacing rules. The DNR must approve any PA involving State-owned minerals.

<u>Unitization Agreement (UA)</u>: An agreement to consolidate acreage into a unitized area for the allocation of production on a basis as defined within the UA or UA Ratification and as approved by the Lessor.

Policy:

Pursuant to Part 5, Section 502, Paragraph 3, of the NREPA, the DNR is responsible for managing State-owned lands and mineral resources to ensure protection and enhancement of the public trust and may enter into contracts for the taking of oil and gas from State-owned lands. As provided under Michigan Administrative Code R 299.8101 – R 299.8107, "Leasing State-owned Oil and Gas Rights," the DNR is authorized to enter into oil and gas leases through competitive bidding at public auction or direct leasing. Upon receipt of a direct lease application, the DNR may instead choose to enter into a lease through public auction if it is deemed to be in the best interest of the State.

The DNR shall continue to study and update methods of monitoring production on State leases to ensure that the State is receiving just compensation consistent with the terms of State leases.

Market studies and sales analyses will be conducted by the DNR to establish trends and patterns that can inform policy and management decisions. These assessments will be for the purpose of continued improvement in the leasing method and the overall oil and gas leasing program for State-owned minerals to (1) ensure that the State lease is competitive; (2) acquire and maintain expertise in the management of hydrocarbon development; and (3) provide that changing conditions are reflected in the overall oil and gas leasing program.

Pursuant to DNR policy, no leases shall be issued that allow drilling or development operations on the bottomlands of inland lakes and streams. Pursuant to statute, no new leases shall be issued for Great Lakes bottomlands.

Administering Division:

Finance and Operations Division, Minerals Management Section (MMS).

Procedure: Public Auction

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- 1. Sets a proposed lease auction date and associated nomination period. Determines lease auction type.
- 2. Makes arrangements to hold an auction.
- 3. Publishes notice of open nomination period as appropriate, in trade journals and on the DNR website.
- 4. Nominates lands for lease where:
 - Drainage is suspected.
 - Unleased State acreage is within an active drilling unit or unitized area.
 - There is unleased State acreage in areas of current development.

Nominator(s)

5. Submits completed form PR4303 Oil and Gas Lease Auction Nomination, with nonrefundable nomination fee, to the Cashier's Office.

Cashier's Office

- 6. Validates and date stamps form PR4303 and deposits fee.
- 7. Forwards validated form PR4303 and supporting documents, if applicable, to MMS.

MMS Staff

- 8. Confirms State ownership of oil and gas rights for nominated parcels.
- 9. Enters the nomination information into LOTS.
- 10. Provides a list of nominated parcels to the Nominator(s) to check for accuracy.
- 11. Coordinates field review/parcel classification as outlined in the Parcel Classification process identified herein.

DNR Field Reviewers

12. Reviews information and enters classification recommendations, comments, and applicable restrictions into PRS.

MMS Staff

- Provides public notification regarding the proposed auction per Michigan Administrative Code R 299.8101 – R 299.8107.
- 14. Creates auction catalog.
- 15. Publishes notice on the DNR Business Calendar.

NOTE: Auction must be published on the DNR Business Calendar for a period of at least 7 days prior to DNR Director approval.

- 16. Obtains written approval from DNR Director or Director's designee to offer nominated mineral rights for lease through public lease auction.
- 17. Sends auction catalog to Nominators.
- 18. Publishes auction catalog on the DNR website.
- Conducts a public lease auction of State-owned oil and gas rights through the auction process, per Michigan Administrative Code R 299.8101 – R 299.8107.
- 20. After conclusion of auction, forwards request for approval to enter into leases to:
 - Director or Director's designee
 - Transportation and Natural Resources Committee
 - State Administrative Board
- 21. Once all approvals are received, generates lease documents through LOTS.
- 22. Sends lease(s) to the proposed Lessees for execution.
- 23. Reviews lease documents and obtains properly notarized signature of intended Lessee.
- 24. Returns lease documents to MMS, as requested.
- 25. Finalizes lease(s) by obtaining a notarized signature from MMS Manager, the DNR Director's designee.
- 26. Sends original executed lease(s) to Lessee.

Procedure: Direct Lease

Nominator

 Submits completed form PR4306 Direct Oil and Gas Lease Application and Requirements, with nonrefundable direct lease fee and proof of qualification, to the Cashier's Office.

Cashier Office

- 2. Validates and date stamps form PR4306 and deposits fee.
- 3. Forwards validated form PR4306 and supporting documents, if applicable, to MMS.

MMS Staff

- 4. Reviews form PR4306 and supporting documents to determine if application is administratively complete.
- Confirms State ownership and checks if requested oil and gas rights are managed by the DNR or another State agency.
- For Development (LD) lease requests ONLY, coordinates field review/parcel classification as outlined in the Parcel Classification process identified herein.

Lessee

MMS Staff

	7. For Nondevelopment (LND) lease requests ONLY, creates parcel classification record in LOTS.
DNR Field Reviewers	8. Reviews information and enters classification recommendations, comments, and applicable restrictions into PRS.
MMS Staff	9. Reviews State agency classification recommendation and authorization to lease non-DNR lands, if applicable.
	 Develops leasing terms and economic factors by comparing the Nominator's proposal with the requirements outlined in Michigan Administrative Code R 299.8101 – R 299.8107.
	 Negotiates lease terms, royalty rate, and bonus consideration with Nominator.
	 Drafts public notification regarding the proposed lease and provides the notification to the Nominator for publication per Michigan Administrative Code R 299.8101 - R 299.8107.
Nominator	13. Publishes public notice per Michigan Administrative Code R 299.8101 - R 299.8107.
	14. Sends original Affidavit of Publication to MMS.
MMS Staff	15. Forwards request for approval to enter into lease to:
	 Director or Director's designee Transportation and Natural Resource Committee State Administrative Board
	16. Generates lease document through LOTS according to approved terms and form PR4304 Oil and Gas Lease Rental and bonus Remittance.
	17. Sends lease document and form PR4304 to Nominator.
Nominator	18. Reviews lease document and obtains properly notarized signature of intended Lessee.
	19. Sends copy of form PR4304, with bonus and rental fee, to the Cashier's Office.
	20. Returns original lease document and a copy of form PR4304 to MMS.
Cashier's Office	21. Validates and date stamps form PR4304 and deposits fee.
	Forwards validated form PR4304 and supporting documentation, if applicable, to MMS.
MMS Staff	23. Verifies payment and finalizes lease(s) by obtaining notarized signature from MMS Manager, the DNR Director's designee.
	24. Sends original executed lease(s) to Lessee.

Procedure: Parcel Classification

MMS Staff

- Receives nominations of State-owned mineral rights to be offered for lease.
- 2. Verifies nomination information has been uploaded into LOTS.
- 3. Identifies parcels automatically classified as LND by PRS due to one or more of the following reasons:
 - Acquisition funding.
 - Deed restrictions.
 - Location within certain management boundaries.
- Forwards list of nominated parcels acquired with federal funding to appropriate land managing division for their reference.
- 5. If applicable, sends a request to the following non-DNR agencies to review and classify lands for oil and gas leasing with a deadline for response:
 - Department of Military & Veterans Affairs (DMVA)
 - U.S. Forest Service (USFS)
- If applicable, enters classification recommendations and supporting background information from DMVA/USFS into PRS.

NOTE: If there are any discrepancies and/or questions regarding the classification recommendations submitted, MMS staff will contact DMVA/USFS for clarification.

7. Forwards a request to DNR Field Reviewers through PRS to review and classify lands for oil and gas leasing with a deadline for response.

DNR Field Reviewers

8. Reviews nominated parcels and enters preliminary classification recommendations, comments, and applicable restrictions into PRS.

LAD Field Coordinator/Assistant Chief

- 9. Reviews classification recommendations entered by the DNR Field Reviewers.
- 10. Resolves any classification disputes.
- 11. Designates a final lease classification (based on parcel classifications) in PRS.

MMS Staff

12. Uploads final lease classification into LOTS.

Procedure: - Reclassification and Amendment

(To change the lease classification on all or part of an existing State Oil and Gas Lease)

Lessee/Designee

1. Submits completed form PR4312 Application to Amend Oil and Gas Lease, with nonrefundable reclassification fee and supporting documents, to the Cashier's office.

Cashier's Office

- 2. Validates and date stamps form PR4312 and deposits fee.
- 3. Forwards validated form PR4312 and supporting documents to MMS.

MMS

- 4. Reviews form PR4312 and supporting documents to determine if application is administratively complete.
- 5. Reviews LOTS to determine whether parcel(s) requested for reclassification are eligible.
- 6. Determines additional bonus due for reclassification, if applicable.
 - If additional bonus is due, notifies Lessee/Designee and ascertains whether they wish to proceed with reclassification.
 - If Lessee/Designee declines to pursue reclassification, withdraws, and closes request in LOTS.
 - If no bonus is due and form PR4312 is complete, notifies the Lessee/Designee the application has been received.
- 7. Enters reclassification nomination information into LOTS and PRS.
- 8. Coordinates field review/parcel classification as outlined in the Parcel Classification process identified herein.

DNR Field Reviewers

- 9. Reviews information and performs a site-specific review to determine whether approval of the request is appropriate.
- 10. Enters classification recommendations, comments, and applicable restrictions into PRS.

LAD Field Coordinator/Assistant Chief

- 11. Reviews classification recommendation(s) entered by DNR Field Reviewers.
- 12. Resolves any classification disputes.
- 13. Designates a final parcel classification in PRS.

MMS Staff

- 14. Reviews final classification submitted by LAD Field Coordinator/Assistant Chief.
- 15. Updates LOTS as necessary.
- 16. If reclassification is approved, drafts public notification, and provides the notification to the Lessee/Designee for publication regarding the proposed lease reclassification.

Lessee/Designee	17. Publishes public notice in appropriate newspaper, as instructed.
MMS Staff	18. Obtains written approval from DNR Director or Director's designee for reclassification.
	 Prepares amendment and form PR4347 Oil and Gas Lease Application Fee and bonus Remittance, if applicable.
	20. Sends amendment and form PR4347 to Lessee/Designee.
Lessee/Designee	21. Reviews amendment and obtains Lessee's notarized signature.
	22. Sends a copy of form PR4347, with additional bonus fee due, to the Cashier's Office, if applicable.
	23. Returns executed amendment and a copy of form PR4347 to MMS.
Cashier's Office	24. Validates and date stamps form PR4347 and deposits fee.
(if applicable)	25. Forwards validated form PR4347 and amendment to MMS.
MMS Staff	26. Verifies payment and finalizes amendment by obtaining a notarized signature from MMS Manager, the DNR Director's designee.
	27. Records amendment with applicable county, if deemed in the best interest of the State.
	28. Sends original, fully executed amendment to Lessee/Designee.
Procedure: - Classification	Review and Amendment
Applicant	 Submits completed form PR4312 Application to Amend Oil and Gas Lease, with nonrefundable classification fee and supporting documents, to the Cashier's Office.
Cashier's Office	 Validates and date stamps form PR4312 and deposits fee. Forwards validated form PR4312 and supporting documents to MMS.
MMS Staff	 Reviews form PR4312, supporting documents, and LOTS to determine whether parcel requested is eligible for a classification review.
	 Coordinates field review/lease classification as outlined in the Parcel Classification process identified herein; updates PRS.
DNR Field Reviewers	6. Reviews information and enters classification

into PRS.

recommendations, comments, and applicable restrictions

Applicant

LAD Field Coordinator/Assistant Chief	Reviews classification recommendations entered by the DNR Field Reviewers.
	Resolves any classification disputes.
	9. Designates a final parcel classification in PRS.
MMS Staff	 Reviews final classification submitted by the LAD Field Coordinator/Assistant Chief. Undetected LOTS
	11. Updates LOTS.
	 If classification is LD or LDR, determines additional bonus due, if applicable.
	 If additional bonus is due, contacts applicant to receive approval to proceed with request.
	14. Drafts public notification regarding the proposed reclassification and provides the notification to the Nominator for publication per Michigan Administrative Code R 299.8101 - R 299.8101.
Applicant	15. Publishes public notice in appropriate newspaper, as instructed.
	Sends original Affidavit of Publication, with copies of any surface owner notification letters, to MMS.
MMS Staff	17. Obtains written approval from the DNR Director or Director's designee for the amendment.18. Prepares amendment and form PR4347 Oil and Gas Lease Application Fee and Bonus Remittance, if
	applicable.
Α Ι' Ι	19. Sends amendment and form PR4347 to applicant.
Applicant	Reviews amendment and obtains Lessee's notarized signature.
	21. Sends original, properly executed amendment to MMS.
MMS Staff	 Reviews the amendment submitted by applicant and, if applicable, verifies payment has been received and deposited.
	23. Finalizes amendment by obtaining notarized signature
	from MMS Manager, the Director's designee. 24. Records amendment with applicable county, if deemed in
	the best interest of the State.
	25. Sends original, fully executed amendment to applicant.
Procedure: Assignment	

Office.

1. Submits completed form PR4058 Assignment of Lease(s), with nonrefundable assignment fee, to the Cashier's

Cashier's Office		Validates and date stamps form PR4058 and deposits fee. Forwards validated form PR4058 to MMS.
MMS Staff	4.	Reviews form PR4058 and processes per the assignment requirements outlined in form IC4307 Lease Assignment Requirements.
	5.	Obtains required MMS approval.
	6.	Records assignment with applicable county, if deemed in the best interest of the State.
	7.	Returns assignment to applicant.
Procedure: Amendment – I	Eor	Intornal Poquaete Only
		Submits recommendation to amend lease for:
DNR Staff	١.	Correction of the acreage figure for parcels under
		lease.
		 Addition of a parcel under certain circumstances. Removal of parcels from lease where State of Michigan title fails.
MMS Staff	2.	Reviews recommendation and determines if appropriate.
	3.	If the amendment is to add additional parcels:
		 Parcel is reviewed through the Parcel Classification process identified herein. Provides public notification regarding the proposed amendment. Obtains written approval from the DNR Director or
		 Obtains written approval from the DNR Director or Director's designee for the Amendment. Prepares form PR4304 Oil and Gas Lease Rental and Bonus Remittance.
	4.	Prepares lease amendment and sends to Lessee.
Lessee	5.	Reviews amendment and obtains Lessee's notarized signature.
	6.	If applicable, sends copy of form PR4304 and bonus and rental fee to the Cashier's Office.
	7.	Sends original, properly executed amendment to MMS.
Cashiers Office (If applicable)	8.	Validates and date stamps form PR4304 and deposits fee.
	9.	Forwards validated form PR4304 to MMS.
MMS Staff	10	. Reviews the executed amendment submitted by applicant.
	11	Finalizes amendment by obtaining notarized signature from MMS Manager, the Director's designee.
	12	. Records amendment with applicable county, if deemed in

the best interest of the State.

13. Sends original, fully executed amendment to applicant.

Procedure: Change of Restrictions and Amendment

Lessee/Requestor 1. Submits completed form PR4312 Application to Amend Oil and Gas Lease, with nonrefundable variance fee, to the Cashier's Office. Cashier Office 2. Validates and date stamps form PR4312 and deposits fee. 3. Forwards validated form PR4312 and supporting documents to MMS. MMS Staff 4. Reviews form PR4312 and supporting documents. 5. Processes application per the change of restrictions requirements, including request for field review, if necessary. **DNR Field Reviewers** 6. Reviews information and enters classification recommendations, comments, and applicable restrictions into PRS. 7. Reviews form PR4312 and supporting documents and MMS Manager makes final recommendation for approval or denial. LAD Field 8. Reviews classification recommendations entered by the Coordinator/Assistant Chief DNR Field Reviewers. 9. Resolves any classification disputes. 10. Designates a final lease classification (based on parcel classification) in PRS. MMS Staff 11. Obtains written approval from the DNR Director or Director's designee for the amendment. 12. Prepares lease amendment and sends to Lessee. 13. Reviews amendment and obtains Lessee's notarized Lessee signature. 14. Sends original, properly executed amendment to MMS. 15. Reviews the executed amendment submitted by applicant. MMS Staff 16. Finalizes amendment by obtaining notarized signature from MMS Manager, the Director's designee. 17. Records amendment with applicable county, if deemed in the best interest of the State.

Procedure: Variance and Amendment

Lessee/Requestor 1. Submits completed form PR4312 Application to Amend

Oil and Gas Lease, with nonrefundable variance fee, to

18. Sends original, fully executed amendment to applicant.

the Cashier's Office.

Cashier Office	2.	Validates and date stamps form PR4312 and deposits fee.
	3.	Forwards validated form PR4312 and supporting documents to MMS.
MMS Staff	4.	Reviews form PR4312 and supporting documents, and processes per the variance requirements, including request for field review.
DNR Field Reviewers	5.	Reviews information and enters classification recommendations, comments, and applicable restrictions into PRS.
LAD Field Coordinator/Assistant Chief	6.	Reviews classification recommendations entered by the DNR Field Reviewers.
	7.	Resolves any classification disputes.
	8.	Designates a final lease classification (based on parcel classifications) in PRS.
MMS Staff	10	Reviews final classification recommendation submitted by the LAD Field Coordinator/Assistant Chief. Updates LOTS.
	11	. Prepares lease amendment and sends to Lessee.
Lessee	12	. Reviews amendment and obtains Lessee's notarized signature.
	13	. Sends original, properly executed amendment to MMS.
MMS Staff	15	Reviews the amendment submitted by Lessee. Finalizes amendment by obtaining notarized signature from MMS Manager, the Director's designee. Records amendment with applicable county, if deemed in
	17	the best interest of the State. Sends original, fully executed amendment to applicant.
Procedure: Pooling Agreen	nen	t and/or Ratification Review
Applicant	1.	Submits a proposed Pooling Agreement (PA) and/or Ratification to DNR.
MMS Staff	2.	Reviews documentation and processes accordingly.

Аррисані	Ratification to DNR.
MMS Staff	 Reviews documentation and processes accordingly. Forwards to MMS Manager for final approval.
MMS Manager	4. Reviews documentation and if approved, executes.5. Forwards executed PA and/or Ratification to MMS staff for processing.
MMS Staff	6. Sends original executed PA and/or Ratification to applicant.7. Updates LOTS and lease file(s) as necessary.

Procedure: Unitization Agreement and/or Ratification Review

Applicant 1. Submits a Unitization Agreement (UA) and/or Ratification request to MMS.

MMS Staff 2. Reviews documentation and processes accordingly.

3. Forwards to MMS Manager for final approval.

MMS Manager 4. Reviews documentation and if approved, executes.

5. Forwards executed UA and/or Ratification to MMS staff

for processing.

MMS Staff 6. Sends original executed UA and/or Ratification to

applicant.

7. Updates LOTS and lease file(s) as necessary.

Procedure: Amendments to Unitization and/or Ratification Agreement Review

MMS Staff

1. Receives Amendment and/or Ratification to existing Unitization Agreement (UA).

2. Reviews documentation and processes accordingly.

3. Forwards to MMS Manager for final approval.

MMS Manager 4. Reviews documentation and if approved, executes.

5. Forwards executed Amendment and/or Ratification to

MMS staff for final processing.

MMS Staff 6. Sends original executed Amendment and/or Ratification

to the existing UA to applicant.

7. Updates LOTS and lease file(s) as necessary.

Procedure: Drainage Review

MMS Staff

1. Discovers possible drainage of State-owned mineral

rights from offset wells.

2. Compiles supporting documentation (e.g., well production and subsurface geologic information) and sends to

Lessee (response due within 30 days).

3. Receives and reviews supporting documentation from

Lessee and sends recommendation to MMS Manager.

MMS Manager 4. Reviews MMS Staff recommendation for drainage

resolution.

5. Notifies MMS Staff of decision on how to resolve drainage.

MMS Staff 6. Notifies Lessee of decision.

7. Monitors Lessee's compliance with resolution requirements and notifies MMS Manager when

compliance is achieved.

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Procedure: Releases

MMS Staff 1. Prepares form PR4058-1 Partial Release of Lease(s) or

form PR4058-2 Full Release of Lease(s) and sends to

Lessee.

Lessee 2. Completes forms PR4058-1 or PR4058-2 and returns to

MMS.

MMS Staff 3. If executed release form not received after 30 days,

lease(s) are administratively released.

4. Updates LOTS and lease file(s) as necessary.

Related References:

IC4307 Lease Assignment Requirements

PR4303 Oil and Gas Lease Auction Nomination

PR4306 Direct Oil and Gas Lease Application and Requirements

PR4312 Application to Amend Oil and Gas Lease

PR4058 Assignment of Lease(s)

PR4058-1 Partial Release of Lease(s)

PR4058-2 Full Release of Lease(s)

PR4304 Oil and Gas Lease Rental and Bonus Remittance (internal use only)

PR4347 Oil and Gas Lease Application Fee and Bonus Remittance

Michigan Administrative Code R 299.8101 – R 299.8107, Leasing State-owned Oil and Gas Rights

27.23-14 – Oil and Gas Leasing is hereby approved.	
DIE: do	11/30/2021
Daniel Eichinger, Director	Effective Date